



State Investment Commission
Monthly Meeting Minutes
Wednesday, February 24, 2016
9:00 a.m.
Room 205, State House

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:05 a.m., Wednesday, February 24, 2016 in Room 205, State House.

I. Roll Call of Members

The following members were present: Mr. J. Michael Costello, Mr. Thomas Fay, Ms. Marie Langlois, Ms. Faith LaSalle, Ms. Paula McNamara, Mr. Tom Mullaney, Ms. Marcia Reback and Treasurer Seth Magaziner. Mr. Frank Karpinski arrived at 9:10 a.m. and Mr. Robert Benson arrived at 9:16 a.m. Also in attendance: Mr. Thomas Lynch of Cliffwater, alternative investment consultant; Mr. John Burns, Mr. David Glickman, Mr. Dylan Lorda and Mr. Allan Emkin of Pension Consulting Alliance (PCA), general consultant; Ms. Sally Dowling of Adler Pollock & Sheehan P.C., legal counsel; Mr. Aaron Snegg and Mr. Matt Novak of IC Berkeley Partners; Mr. Robert Weaver, Ms. Maggie Littlefield Sahlman and Ms. Sarah Smith of Advent International; Mr. Ron Murphy and Ms. Donna Wilson of Invesco; Mr. Chris Reimer and Mr. David Malone of Ascensus College Savings; Ms. Lauren Lusthaus and Mr. Matthew Newman of Institutional Shareholder Services (ISS); Ms. Anne-Marie Fink, Chief Investment Officer and members of the Treasurer's office staff.

Treasurer Magaziner called the meeting to order at 9:05 a.m.

II. Approval of Minutes

On a motion by Ms. Marcia Reback and seconded by Mr. Tom Mullaney, it was unanimously

VOTED: to approve the draft of the minutes of the January 27, 2016 meeting of the State Investment Commission.

III. Portfolio Asset Allocation Review

Treasurer Magaziner introduced Mr. Allan Emkin and Mr. John Burns of Pension Consulting Alliance (PCA) to provide an overview of the portfolio's asset allocation. Mr. Emkin started by describing the attributes of the plan, saying the plan is mature, with a growing retirement-age population and a stagnant population of active employees. He noted that this is a significant population change from public plans thirty-five years ago and that asset allocations need to adjust accordingly. Mr. Emkin stated that the average public pension plan as of 2013 was approximately 75% funded and featured one-and-a-half active employees to each retiree. He compared this standard to the Rhode Island plan, which currently stands at approximately 60% funded with one active employee for each retiree. As a result, the average national pension plan has negative cash flow of less than 3%, whereas the Rhode Island plan has negative cash flow of more than 5%.

Mr. Costello asked about PCA's ability to project these outflows five or more years into the future. Treasurer Magaziner answered that the state actuary would make such a projection, not PCA. He added that it would be beneficial to have the state's actuary appear before the SIC in the future.

Mr. Emkin continued, adding that liquidity is a growing challenge for all public pension plans. Additionally, the average assumed rate of return nationally is approximately 7.5% and is likely to trend down to 7.25% or 7.0% over time. He noted that exposure to equity risk is the leading risk for most public pension plans.

Rhode Island has maintained a lower risk profile than the average plan. Diversification has been a helpful and appropriate strategy for the portfolio.

Mr. Fay asked if PCA measured overall portfolio liquidity. Mr. Emkin responded that PCA's "shortfall management" analysis has successfully projected liquidity needs for the portfolio. He added that a major drawdown of assets is a threat to any underfunded pension plan.

Ms. Langlois asked if PCA has conducted any simulations of how the plan would address a significant asset drawdown event. Mr. Emkin answered that such projections were made as part of the most recent asset liability study conducted approximately four years ago. Ms. Fink added that Treasury anticipates conducting another study in the second half of this year.

Ms. Reback noted that similar studies occurred as part of the recent pension reform legislation.

Next, Mr. Burns explained that an overall impact of underfunding in public pension plans is a lack of flexibility. He then reviewed the market returns for various asset classes over the last five years, noting the negative impact of emerging markets and commodities. All sectors were challenged in the recent one-year period save for real estate. Mr. Emkin highlighted previous bond yields of 4% or 5% in comparison to current yields on a ten-year Treasury of only 1.75%. He said that this example shows the impact of macro-economic developments on portfolio performance. Mr. Burns added that performance was aligned with plan benchmarks and that the tracking error of 1% was average. He reiterated that the portfolio enjoyed less volatility than the average public pension plan.

Mr. Robert Benson asked if the portfolio's limited volatility was a result of effective implementation or simply that private assets are not marked-to-market daily. Mr. Burns said that it was a result of both factors.

Ms. Fink added that hedge funds are marked to market and both private equity and real estate classes are a lower component in the Rhode Island portfolio than the average plan.

Mr. Burns reviewed each of the individual asset classes. He began with global equity, which is managed passively in line with benchmarks. The board asked questions about the international equity allocation and discussed the impact of recent market movements on forward expectations. Mr. Emkin suggested the allocation between US and non-US stocks is being reviewed by many other public plans and that this topic should be considered as part of the next asset/liability study.

Mr. Burns continued reviewing the real estate, private equity and fixed income asset classes. Mr. Fay asked if the fixed income segment provided liquidity during the recent equities downturn. Mr. Emkin explained that fixed income did provide stability during that period. Mr. Burns ended by reviewing the real return, absolute return and hedge fund segments. He explained that segments successfully fulfilled their roles within the portfolio. He noted that hedge funds provided more return per unit of risk, which is what they were designed to do.

Mr. Benson asked if it is possible to confirm the hedge fund valuations. Ms. Fink answered that every fund in the portfolio has a third-party administrator and that a majority of hedge funds in the portfolio own publicly traded (level one) securities. There are some level two and level three assets within some of the portfolio's hedge funds, but ultimately the funds can be considered marked-to-market. Treasurer Magaziner asked if Cliffwater could provide an analysis of level one, two and three assets within hedge funds at the next monthly meeting. Mr. Lynch confirmed that this analysis would be provided.

Mr. Emkin concluded by mentioning the effectiveness of the SIC's focus on absolute return and low-beta equity strategies within the hedge fund allocation, which worked better than other plans' approaches to hedge fund selection.

IV. IC Berkeley Partners IV Recommendation

Treasurer Magaziner introduced Mr. David Glickman of PCA. Mr. Glickman provided a brief overview of the real estate market, noting the asset class, including both core and value-add investments, was performing well within the portfolio. Mr. Glickman reminded members that the SIC committed \$18 million to IC Berkeley Partners Fund III, and then introduced Mr. Snegg and Mr. Novak of IC Berkeley Partners.

Mr. Snegg provided an overview of Fund III performance, and described the anticipated structure of Fund IV. Mr. Snegg explained that IC Berkeley is seeking to continue the successful model utilized in Fund III. He said that the firm focuses on light-industrial properties. Mr. Novak explained that this large sector offers robust investment opportunities. He added that light-industrial properties have had higher occupancy and rents than the broader industrial real estate sector.

Mr. Novak said that Berkeley Partners focused on properties close to city centers where demand is strong. He pointed out that there is little new light-industrial real estate development in the U.S., preventing a supply overhang and keeping rent levels high, a positive feature. Mr. Novak noted that holdings are concentrated in states that exceed national averages for population, rent and job growth. Mr. Snegg reiterated that properties are managed by IC Berkeley employees, which allows for increased control and value generation.

Mr. Novak provided an overview of the organizational chart. He explained that management has been stable and that four new employees would be added in anticipation of Fund IV.

The board asked questions. Mr. Novak concluded by reviewing Fund IV's discounted terms for Rhode Island as a potential early investor. Guests from IC Berkeley left the room.

Mr. Glickman described the role of this investment in the portfolio, and recommended a \$30 million investment, limited to no more than 15% of the total amount of funds raised for Fund IV should IC Berkeley not reach its fundraising goal.

The board asked questions.

On a motion by Mr. Michael Costello and seconded by Ms. Marcia Reback, it was unanimously **VOTED: to approve a commitment equal to the lesser of 15% of total commitment or \$30 million to IC Berkeley Partners Fund IV, subject to successful negotiation of terms.**

V. Advent International Fund VIII Recommendation

Mr. Lynch provided an overview of Advent International GPE Fund VIII. He then introduced Ms. Sahlman, Ms. Smith and Mr. Weaver of Advent International. Mr. Weaver presented details of the firm's history and structure. He explained that the firm has a large team of one hundred and seventy-four employees. He attributed Advent's success to a strong culture and stable staff. Mr. Weaver noted that Fund VIII would include more domestic investment than past funds, which had a larger percentage within Europe.

Ms. Reback asked if any of the senior management are women. Ms. Sahlman answered that approximately 10% of managing directors are women. She added that promoting more women to the senior level is a goal moving forward. Ms. Smith noted that women make up approximately 30-40% of junior level roles.

Mr. Weaver listed the various industries that Advent specializes in. He noted that the firm's partners have made a significant co-investment of \$350 million in GPE Fund VIII.

Ms. Smith explained how the firm focuses on growing operating profit at their portfolio companies. She highlighted the recent success Advent International had in the payment processing sector as an example of the firm's capabilities. Ms. Smith explained that the firm's operating managers and support team have relevant industry experience and assist companies in becoming more efficient.

The board asked questions about the strategy, compensation and fees, particularly the change in the fee structure. Guests from Advent International left the room.

Mr. Lynch reiterated the terms and details of GPE Fund VIII. The board asked questions about Advent eliminating the preferred return feature from its fee structure. Mr. Lynch said that the firm's history of success provides confidence to Cliffwater that Fund VIII will meet expectations despite the change. The board discussed the change and the need to have a large enough commitment to have an impact.

On a motion by Mr. Michael Costello and seconded by Ms. Marcia Reback, it was unanimously **VOTED: to approve a commitment of at least \$20,000,000 and up to \$30,000,000 to Advent International GPE Fund VIII subject to successful negotiation of terms.**

VI. 529 Plan Socially Responsible Investment Recommendation

Ms. Fink briefly reviewed the investment line-up for the 529 CollegeBoundfund. She said that Treasury expects interest in a socially responsible investment (SRI) option similar to what is offered in the defined contribution retirement plan. Ms. Fink introduced Mr. Murphy and Ms. Wilson of Invesco as well as Mr. Reimer and Mr. Malone of Ascensus College Savings to describe their SRI recommendation.

Ms. Wilson described the proposed investment option as maintaining Invesco's overall investment standards while considering mandated social and ethical factors. She described the firm's experience in managing other SRI portfolios over the last fifteen years.

She explained the approach that Invesco will take for the CollegeBoundfund's SRI fund. Ms. Wilson said that exposure to fossil fuels would be limited by removing oil, gas, coal and power producers. For societal concerns, exposure to abortion, firearms, alcohol and pornography, tobacco and genetic engineering would be eliminated. She anticipates a universe of compliant companies of approximately one thousand companies, most of which are in the MSCI World Index. Then Invesco will use quantitative assessments of four factors, earnings estimates, market sentiment, management and quality, and value, to build value-adding investments for the portfolio.

The board asked questions.

On a motion by Mr. Michael Costello and seconded by Mr. Thomas Fay, it was unanimously

VOTED: to approve the proposed 529 CollegeBoundfund Socially Responsible Investment option for both the direct and advisor-sold plans, subject to successful negotiation of terms.

VII. Proxy Advisor RFP Recommendation

Treasurer Magaziner introduced Ms. Lusthaus and Mr. Newman of Institutional Shareholder Services (ISS). Mr. Newman provided an overview of the firm and organizational structure. ISS specializes in corporate governance research and proxy voting advisory services. He said that the firm employs over nine hundred staff. Mr. Newman added that ISS seeks to provide institutional investors with expertise and relevant analysis on companies and their governance. The firm has developed a comprehensive online platform that is used for research and daily interaction with the analysts assigned to the client. He noted that ISS seeks to cover all possible companies and currently oversees proxy voting for 39,000 firms around the world. The board asked questions about how ISS develops its policies. Treasurer Magaziner said that the SIC and Treasury staff would spend time developing a custom policy, adapting an "off-the-shelf" ISS policy to align with the SIC's established investment policy statement.

Concerning the scope, Ms. Lusthaus explained that ISS could initially only vote on domestic shares with international voting potentially being added at a later date. She said that this is a common industry structure. Ms. Lusthaus reviewed the terms of the ISS proposal.

On a motion by Mr. Michael Costello and seconded by Mr. Robert Benson, it was unanimously

VOTED: to approve Institutional Shareholder Services (ISS) as the new Proxy Voting and Corporate Governance Advisor.

VIII. Legal Counsel Report

There was no legal counsel report.

IX. Chief Investment Officer Report

Ms. Fink reviewed the performance of the portfolio for January. The portfolio was down 2.96% for the month. She noted that January was a challenging month for markets overall. The Quality-Value-Momentum (QVM) factor-tilt portfolio continued to perform well, though it is still early.

Ms. Fink highlighted various changes that were made to the SIC book to make the book more user-friendly. She provided an update on the 529 CollegeBound*fund* transistion. Legal counsel is assisting Treasury with three different contracts relating to this process. She said that the SIC will continue to receive updates as this significant process continues forward. Treasury staff has also been working with TIAA-CREF to develop a comprehensive participant outreach plan. Lastly, Ms. Fink noted that Treasury would be working with cities and towns on Ocean State Investment Pool opportunities now that short-term rates have increased.

X. Treasurer's General Comments

Treasurer Magaziner thanked members for their time and patience during this lengthy meeting.

Ms. Reback asked if Mr. Padwa could provide an update on class action lawsuits at the next SIC meeting. Treasurer Magaziner confirmed that this could be added to the March agenda.

There being no other business to come before the Board, on a motion by Ms. McNamara and seconded by Ms. Marie Langlois the meeting adjourned at 11:57 a.m.

Respectfully submitted,

**Seth Magaziner,
General Treasurer**